



NORTH DAKOTA'S LOAN RESOURCE

TO:

NCUA

FROM:

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RE:

Comments on proposed
Rule PCA Rule 606 (Capital)

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☒ URGENT☐ FOR REVIEW☐ PLEASE COMMENT☐ PLEASE REPLY☐ PLEASE RECYCLE

NOTES/COMMENTS:

Details to print

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May 15, 2014

Gerald Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Dear Mr. Poliquin and Board members,

I am writing today to respond to your Risk-Based Capital proposal for credit unions over \$50 million in assets. I would like to commend NCUA on developing some type of solution for legislating the amount of capital a credit union should hold based upon the level of risk it may pose to the insurance fund. I understand the attempt by NCUA to address each and every major operating risk known to credit unions in one regulation. While I am not sure that is the intent of our nation's regulators, I do recognize that this is not an easy task given the extremely diverse risks that each credit union poses in serving its own unique membership.

Let me begin by stating that Citizens Community Credit Union (CCCU) operates within a state that has a population base less than most large cities in the United States. We face tremendous competition from other banks, other credit unions and unregulated lenders from inside and outside our state. CCCU has an exemption from the business lending portfolio limitations due to all of the reasons listed at the time of implementation of the original Member Business Lending regulation—we have been a business and agricultural lender since founded in 1940 and a majority of our portfolio was and is made up of these types of loans. We are a low-income designated credit union and an approved Community Development Financial Institution (CDFI).

There was a purpose for the waiver of business lending limitations at the time the business lending regulations were written. And that reason was, quite simply, without it credit unions like CCCU would have ceased to exist. It is no different today. Without a waiver from the extremely rigid lending limitations within the MBL regulation, credit unions like CCCU would struggle mightily to survive—and very well may not survive. Your proposed capital regulation makes this very necessary waiver unnecessary at best. Should this proposal be enacted as is, CCCU and all credit unions like it will need to severely restrict lending to small businesses, farmers, ranchers and even some consumers at a time when the availability of credit, especially to smaller operators and consumer of modest means, is urgently needed.

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For the above reasons, I believe you should be able to understand the tremendous challenges we face daily simply to survive. As you should know, CCCU is one of the 'relatively few' credit unions that NCUA staff feels will be affected by this regulation. I am telling you that we will not simply 'be affected' but will be required to make drastic changes in a very short period of time that will reduce or eliminate our ability to compete with other institutions, primarily banks, and shift operating focus from serving our membership to basic survival. If enacted as it, this regulation will absolutely force us to reposition balance sheet assets, abandon growth plans, deny members certain loans, reduce or eliminate member services and cut expenses to achieve an even higher level of profitability and hopefully improve the capital ratio just to avoid potential excessive and relentless regulatory oversight activities.

While there is, like most regulations, something good in this Risk-Based Capital proposal, consideration must be given to how it is ultimately implemented. The financial industry has just recovered from a major period of financial adjustment. There have been tremendous regulatory changes for all of us to deal with and implement in just about every area of operation. Already, more changes are being considered to those regulations to ensure they do not overly burden financial institutions or our country. Just why is NCUA so eager to add to that regulatory burden with yet another over-reaching regulation and not allow time for adequate industry assessment and comment?

Banks have had a number of years to adjust to their capital standards and will be given additional years to comply. I have very deep concerns for how NCUA thinks a regulation dealing with capital standards and every single major area of credit union operation can or even should remotely be considered for forced compliance in only months. Not only would we be required to comply with explicit rules, it further appears that subjective judgment for capital adequacy in a credit union will be included in this proposal. This regulation apparently gives examiners the ability to deal with perceived deficiencies that may not be 'drawn solely from the level of a credit union's regulatory capital ratios'. From my years of experience, all of this will put credit unions, and specifically CCCU at a huge competitive disadvantage the minute capital ratios decline for any reason at all. And then the excessive and relentless regulatory oversight activities will begin.

The risk-weighting of the very assets that allow us to fulfill our mission as a low-income, Community Development Financial Institution will drastically affect our ability to continue making a difference due to the fact that for every new dollar we loan, we must earn twice the return just to maintain capital levels. If we can somehow double the price of the loan maybe we can maintain our capital ratio. I am sure that is something our competition would very much like to see happen as soon as possible. This arbitrary, unproven need to risk weight all member business loans at this extremely high weighting factor with no regard to credit quality is unnecessary, dangerous and destructive to our credit union.

Basel III for banks appears to be much less destructive to their operations than your proposal is for credit unions. In my opinion, risk weighting of specific classes of assets simply due to concentration levels and/or duration is misguided and will prove to do little to protect the insurance fund. It is the quality of all assets that will be the final determination of those results.

One of my topmost concerns is the ability of credit unions to compete in a highly competitive market place for financial services. I believe that this regulation will force credit unions to turn from its historical purpose of serving members to making money. It is an unfortunate fact but profit is the only way credit unions can increase capital. It has been my personal experience that, despite publicly supporting secondary capital, NCUA has not been supportive when such an opportunity actually exists for a credit union and your approval is required. Management focus will necessarily shift from traditional areas of

concern such as meaningful and affordable services to capital-building activities such as: reduced dividends, increased loan rates, more fees, rebalancing of all assets on the balance sheet to more profitable areas, reduced credit availability to consumers of low means, small businesses and farmers and rejection of deposits to name a few. I have an important question for NCUA to ponder- in the future, what will it mean to even be a credit union should this regulation go into effect as it is now proposed? I wonder how we will be able to say, as we proudly do today, that we are member-focused.

It is my opinion that NCUA has implemented numerous regulations over the recent past that gives it nearly all of the authority and tools needed to incent credit unions to build capital without another such all-encompassing specific capital regulation. We are already complying with strong regulations dealing with liquidity, concentration, interest rate risk and other areas of operation directly affecting capital and adequate levels of capital based upon these areas of risk. Once again, I support a risk-based approach to setting capital standards but there is absolutely no need for such obvious and burdensome duplication of regulation.

CCCU is a state-chartered, federally insured credit union. Our state has experienced several major economic cycles over the more than 30 years that I have led this credit union. Our State Regulator has been instrumental in helping our credit union, as they have many other credit unions in this state, survive these severe economic cycles. They have done this thru stable, conservative, and consistent application of local principles and an understanding of the unique economic regional challenges and risks.

I see your capital regulation as further restricting local control of the credit unions in the State of North Dakota. No regulation will prevent negative economic results from impacting the capital in credit unions. What I do know is that this regulation will only serve to reduce the number of credit unions in this state because a credit union may suddenly not measure up to federal standards. You only need to look at CCCU's history, along with a handful of other North Dakota credit unions, who survived extremely difficult economic times due to the strength and understanding of our North Dakota Department of Financial Institutions- not a federal regulation. I am proud to say that many farmers and small business owners were given the ability to pass their operation on to another generation of operators due mainly to the wiliness and ability of CCCU to assist them when no one else would. I urge you to look at what this credit union has accomplished and overcome over the past quarter plus century. It has not been easy by any means. But, the cooperative spirit that binds lender and borrower is proven strong in our history. Implementing this regulation ignores any of that and will destroy any cooperative motives in favor of making money.

In my opinion, this rule will severely punish our credit union for providing the services that our community and state need. Line of credits to agricultural producers and small businesses are a critical product and necessary for them to survive the leaner periods of time. For CCCU, much of this lending is on a routine, seasonal basis. Upon completion of last years operating cycle we carried about 13 million in unfunded commitments. Under your capital proposal, and only because these lines have a remote chance of being accessed, these commitments would increase our balance over 8% and our capital ratio would decline by more than one-half percent.

As a CDFI and low income designated credit union, our consumer lines of credit assist members of low means with both their saving and borrowing needs, building credit history and fulfilling every day living needs. They are not very profitable for CCCU and, with the additional burden on capital it is likely one of the services we may no longer be able to provide.

The exclusion of the NCUSIF deposit from the net worth calculation is particularly disturbing to me. This deposit, we were told originally, was made as equity to our insurance fund. The earnings on the fund and the principle were available to cover losses for liquidating credit unions. Recently, the term 'investment' was attached to our equity deposit in our insurance fund. Either term, if managed effectively by NCUA, should not result in the total exclusion of this large sum of money from any other asset on the balance sheet.

While our credit union is enjoying one of the longest and 'best' periods for loan delinquency and charge-offs in its history, that has most certainly not been the case ever before. Low-income families live in the 30-60 day delinquency category. As a low-income, Community Development Financial Institution, and most importantly as a Credit Union, it is our responsibility to do what we can to work with and improve the livelihood of those members. Our board, our staff and upper management all take that responsibility seriously and have pledged and promised to utilize our financial strengths to do that.

By assigning a higher risk rating to moderately delinquent borrowers, all of our programs will either need to be scrapped or adjusted just to focus on capital growth. Once again, this type of lending is not tremendously profitable, takes educated and motivated staff and unwavering commitment to the programs. It is not something we can do today and not tomorrow. Rather, it is something we live on a daily basis. We are used to managing higher delinquency rates and working with credit challenged members as well as having a proven track record and acceptable or even lower charge-offs. And yet again, the requirements under your proposal are much higher than those under Basel. Why in the world would NCUA want to contribute to the destruction of the actions that make America's credit unions great when there are more reasonable options?

In addition to all of the other rules and regulations this proposal seeks to duplicate, we are also required to comply with GAAP in regards to assessing loan loss reserves. We use a futuristic approach in analyzing our potential charge-offs and use that to assess the adequacy of our Loan Loss Allowance Accounts. This is yet another reason it makes little sense to incorporate every single regulation into this one capital proposal and thereby eliminate so much of what a credit union is about.

In summary, there is no doubt that, should this regulation go into affect as presently posed, CCCU and its membership will suffer greatly. We will become less competitive to banks and profit motives will drive all credit unions at the expense of member focus. I encourage the board to consider the probable outcome of these facts and how you can even continue to tout and promote a 'credit union difference'. Where would you expect that difference to originate from? I submit there will be little to no difference in how a credit union operates in the eyes of its membership. Where would you expect the 'grassroots' support for credit unions to come from then?

I encourage the NCUA board to consider the following:

1. Allow for an implementation period of much, much longer than 18 months. I can not under any circumstances, see any justification for implementation in such a short period of time
2. Consider separating agricultural lending from commercial lending. There exists all sorts of proof that credit unions truly serving their members with Member Business Loans (vs. 'commercial' loans) and Agricultural loan products had anything to do with the losses stated in NCUA analysis

3. Allow additional time for comment on the effects of this far-reaching regulation on all credit unions, credit union organizations and State Regulators. There appears no justification or need for fast-tracking a capital regulation especially with all of the regulations currently in effect to deal with just about any regulatory concern you could imagine

4. Consider reducing or eliminating the burden of duplicate regulations dealing with liquidity, concentration and other risks that would purportedly be dealt with by this new Risk-Based Capital regulation

5. Fully consider the definition of 'complex' credit union and what that really means to the insurance fund. Credit unions presently not being covered by the \$50 million dollar threshold will soon be there. What will the impact be on them when that happens? How will NCUA deal with credit unions not meeting requirements when that happens? Will the action lead to even fewer credit unions in the next few years?

6. Fully consider the need for the proposed capital thresholds. Why implement this regulation with what appears to be an unnecessarily high level of capital- why use 10.5% rather than the current 7% or even 8%?

7. Unguaranteed student loans are at 100% while unsecured consumer loans are at 75%. Why is there this difference? It is our experience and program that student loans are underwritten carefully, generally have cosigners, requires them to make small, periodic payments, and are even privately insured. These borrowers will have a good future and will likely repay their loans with little problem as they advance thru their chose fields of endeavor. Having proven a successful educational life, why would NCUA expect them to be any less successful in their financial life repaying their student loan debt. And even for those few that may not be completely successful, there are more secondary and tertiary sources of repayment than any unsecured loan most likely has.

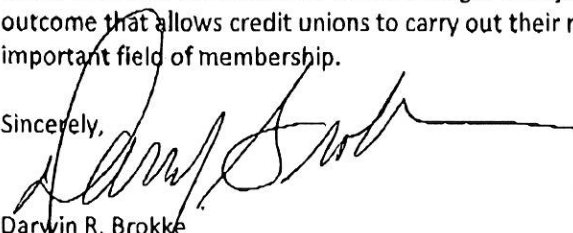
8. Remove the unfunded commitment rule or completely re-think the need for incorporating something that should be managed thru the ALM and Liquidity rules and regulations already in place.

9. Include the NCUSIF deposit for net worth calculation.

10. Advance and fast-track the opportunities for credit unions to obtain secondary capital. There will be little that will be more important to us should this regulation be enacted in its current status.

I would like to thank you for the opportunity to comment on this highly critical piece of legislation. I am truly concerned over the effects it will have on our credit union and how it will change the way we operate and serve our members in the future. I encourage much more transparency and dialogue with credit unions as we move into the next stages of adjustment and implementation. I look forward to an outcome that allows credit unions to carry out their mission of serving each and every unique and important field of membership.

Sincerely,



Darwin R. Brokke
President